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SIPDIS

BUSINESS SENSITIVE

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SUBJECT: SE TURKEY ECONOMY LINKED TO TEXTILE CHANGES, IRAQ

1.(SBU-BUS SENS) Summary: Southeast Turkey's economy continues to be slow and characterized by underemployment. A few stronger regional companies, such as SANKO GROUP and several Adana/Mersin construction companies, have repositioned themselves to do business in Iraq or make new investment to adapt to international competition. The container/bulk port in Mersin and fuels terminal in Iskenderun are healthy, in part because of Iraq-related business, as is the parastatal steel smelting plant, Is-Demir, in Iskenderun., which is processing large amounts of scrap steel from Iraq. They are, however, exceptions to the rule in an economy still largely linked to textiles and agriculture. End Summary.

Where SANKO GROUP is headed on Textiles

2. (SBU BUS) The SANKO GROUP announced on March 20 that it will invest USD 75 million in Adiyaman province under the new incentive law to build three new factories to expand its yarn and ready-wear capacity in textiles. According to Abdulkadir Konukoglu, the first factory will be ready next year and will employ 1,500 people, with two more factories coming by 2007. The last two factories' employment potential is unknown.

SANKO Getting Leaner in Process

3. (SBU SUS SENS) Konukoglu in another discussion told PO that Sanko had reached full capacity at its existing Gaziantep site and needed to expand elsewhere to maintain its competitive position. He saw the Adiyaman investment as important to raising SANKO's manufacturing productivity as the expiration of the Multi-Fiber Agreement approaches in 2005. While the Adiyaman investment will introduce 150,000 yarn spindles to SANKO's industrial base, SANKO will gradually retire a similar number of older spindles from its older plant in Gaziantep, shedding approximately 800 jobs by 2007 in the process. By 2007, SANKO will therefore have retained its existing 500,000 spindle manufacturing base, but created growth room (in Adiyaman) and increased labor productivity.

SANKO Sees Textile Future For Itself

4.(SBU BUS SENS) Konukoglu said competition with Chinese textiles after 2005 will be challenging, but he thought that SANKO still had lower shipping cost, indigenous cotton supply and superior European client relationship advantages to balance out lower Chinese cost bases. He said that SANKO also has agents in China looking for clients and joint venture opportunities there. SANKO intended to keep moving up the product value chain to retain its competitiveness, he said, mentioning how Chinese products would not be in direct competition with SANKO products for at least several years. By then, he anticipated that Chinese WTO compliance especially unfair labor practices; economic shocks; textile market shifts; and greater Chinese financing costs once state banks became insolvent would create a more transparent and more level playing field for Turkish-Chinese textile competition, especially in Europe, but even so for some North American markets. He anticipated that SANKO, with its large established European and North American customer base (LEVI's, e.g.), flexible product lines attuned to client needs and deep pockets could make it through the difficult transition years of 2005-2008, but he doubted many other Turkish companies would be able to do likewise.

Meanwhile SANKO joining up with China on other businesses

5.(SBU SUS SENS) He added that SANKO, already a distributor of Chinese brand HAIER appliances and electronics, was expanding its distribution channels for the brand. He said that he had been impressed with the brand's product quality for several years, but now saw that they were bringing "new technology, really good stuff" to the market that would challenge Turkish local appliance producers, Japanese brand license products and European perennials. "They have turned a corner at HAIER and we

want to expand our business with them," Konukoglu said.

Turkish Construction doing business in Iraq~

6.(SBU BUS SENS) On the margins of a recent Iraq reconstruction conference, we discussed ongoing business with several Adana-based construction firms. They noted that the construction business was still in a downturn in southeast Turkey, but that they had tried to make up for the slow economy here with construction jobs for the U.S. in Iraq. One construction company, Kulak construction, has completed about USD 15 million in projects in Iraq and projects that it could deliver almost USD 40 million in construction contracts by the end of 2004. Its work is primarily centered at the Balad CAMP ANACONDA area near Baghdad. Another company, ER-KA Limited, said that it had done several million dollars of construction for the U.S. in Kirkuk and now was regularly supplying several hundred thousand dollar apiece supply contracts to U.S. military consumers in Iraq for telecommunications, vehicle fleet maintenance and logistics.

But still wary about diving in with two feet

7.(SBU BUS SENS) Most southeast Turkish business contacts said that they were interested in pursuing further subcontract work in Iraq, but were still very concerned about security and asset protection. They said that the security instability made projects risky for their employees, hard to deliver according to contract timelines and quality levels and posed sometimes unacceptable risks to their assets, for which insurance was largely unavailable. They also said that the widespread requirements for bid bonds at project levels of USD 5 million and above was discouraging, since Turkish banks were hesitant to participate in that market and they rarely held sufficient capital to finance such requirements internally.

Iskenderun Busy with Fuel and Steel

8.(SBU BUS SENS) The Iskenderun area in Hatay province is also faring well because of investment by Tosyal steel to expand its roll steel capacity and the increase in scrap steel processing largely from Iraq at nearby parastatal steel smelting plant, Is-Demir. The fuels terminal in Iskenderun is also handling much of the transloading for humanitarian and increasingly some key U.S. force operational fuels bound for Iraq. Some local contacts note that employment is increasing by at least several hundred jobs in Iskenderun because of the steel sector expansion, but note that most money from fuel purchases "only goes to Istanbul where the companies operating the Iskenderun terminals have their headquarters." The fuel terminal operation at Iskenderun does seem to be enjoying higher productivity because of Iraq-related business.

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